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Cornhusker Economics

2019 Nebraska Property Tax School Funding Issues

Market Report	Year Ago	4 Wks Ago	2-22-19
<u>Livestock and Products.</u>			
<u>Weekly Average</u>			
Nebraska Slaughter Steers, 35-65% Choice, Live Weight.	125.41	122.18	126.50
Nebraska Feeder Steers, Med. & Large Frame, 550-600 lb. . . .	200.00	178.48	178.24
Nebraska Feeder Steers, Med. & Large Frame 750-800 lb. . . .	156.82	149.12	145.83
Choice Boxed Beef, 600-750 lb. Carcass.	216.53	216.71	217.72
Western Corn Belt Base Hog Price Carcass, Negotiated	62.74	50.91	45.67
Pork Carcass Cutout, 185 lb. Carcass 51-52% Lean.	78.42	66.98	58.78
Slaughter Lambs, woolled and shorn, 135-165 lb. National.	139.07	NA	133.16
National Carcass Lamb Cutout FOB.	369.76	389.33	377.13
<u>Crops.</u>			
<u>Daily Spot Prices</u>			
Wheat, No. 1, H.W. Imperial, bu.	4.14	4.59	3.97
Corn, No. 2, Yellow Columbus, bu.	3.44	3.52	3.49
Soybeans, No. 1, Yellow Columbus, bu.	9.50	8.17	8.08
Grain Sorghum, No.2, Yellow Dorchester, cwt.	5.65	5.71	5.55
Oats, No. 2, Heavy Minneapolis, Mn, bu.	2.93	3.25	3.19
<u>Feed</u>			
Alfalfa, Large Square Bales, Good to Premium, RFV 160-185 Northeast Nebraska, ton.	*	165.00	177.00
Alfalfa, Large Rounds, Good Platte Valley, ton.	90.00	105.00	105.00
Grass Hay, Large Rounds, Good Nebraska, ton.	*	87.50	85.00
Dried Distillers Grains, 10% Moisture Nebraska Average.	144.00	147.00	140.00
Wet Distillers Grains, 65-70% Moisture Nebraska Average.	48.50	56.00	51.00
* No Market			

Nebraska agricultural property taxes are among the highest in the United States. Over the last three years, Nebraska farmers and ranchers have paid nearly 31 percent of their net farm income as property taxes (47 percent in 2017). When state and federal taxes are factored in, this represents an effective tax rate of more than 50 percent (over 60 percent in 2017). While no one particularly enjoys paying property taxes (or any other tax), property taxes are especially burdensome for Nebraska farmers and ranchers.

The proposed 2020 constitutional amendment to provide property tax relief would require dramatic state spending cuts, equally dramatic state sales and income tax increases, or both. This newsletter provides an introduction to the role of property taxes in financing state and local government in Nebraska as well as K-12 education. We then examine some of the major property tax relief proposals and how they might impact taxing and spending in Nebraska.

Nebraska ag land property tax crunch. Nebraska property taxes on agricultural land as a percentage of net farm income are 146 percent of the United States average (1950-2017 data). This means that for every \$1.00 of agricultural income that United States farmers and ranchers pay on average for property tax, Nebraska farmers and ranchers pay \$1.46, or almost one and a half times as much. So Nebraska agricultural property taxes are significantly higher than what most United States farmers and ranchers pay. And it has gotten worse in recent years: the 20-year average is 150 percent, the 10-year average is 147 percent, the 5-year average is 164 percent and the 3-year average is 188 percent.

Role of property taxes in Nebraska. Property taxes are the single largest tax paid in Nebraska, accounting for 38 percent of total state and local tax collections. Sales taxes are 29 percent of total taxes, and income taxes are 26 percent. Sixty percent of property taxes go to K-12 education funding. All property taxes fund local government--cities, counties, and local school districts. All income taxes and 84 percent of sales taxes are used to fund our state government.

Balancing tax sources? One public finance approach suggests that the tax load is fairest if it is evenly spread across the types of taxes collected. This suggests that the amount of revenue raised by property taxes, sales taxes and income taxes should be roughly about the same. If Nebraska property taxes, sales tax and income taxes were equalized as sources of state and local revenue, property taxes would need to be reduced over \$600 million, sales taxes would go up about \$200 million and income taxes would increase around \$400 million. While maintaining exactly equal shares among the different taxes would be impractical, moving towards a more equal shares approach would probably strike many taxpayers as being fairer.

How high are Nebraska taxes? One way to evaluate this is to compare Nebraska's taxes with those of other states. In a national comparison, Nebraska property taxes are the 10th highest in the United States; sales taxes are the 9th lowest, income taxes are in the middle (26th out of 50) and the overall tax burden is also in the middle (24th out of 50) (Tax Foundation 2019 business climate study). One reason Nebraska sales taxes are relatively low is that we do not tax services, while many other states do.

How about school taxes? According to United States Census Bureau statistics (2014-15 data), Nebraska state school aid is the twelfth lowest in the United States, while the local share of K-12 school spending (property taxes) is the second highest. This suggests that property taxes may be bearing too large a share of public education costs and that some of these costs should be shifted onto sales and income taxes.

2018 property tax relief petition. The 2018 property tax relief petition would have given ag and residential property owners refundable state income tax credits for 50 percent of their property taxes that went for K-12 education, or about 30 percent on average. Paying for the property tax credits would have cost \$1.1 billion or 25 percent of the state general fund budget. The 2018 property tax relief initiative would have given many homeowners several hundred dollars of state income tax credits and ag property owners state income tax credits of several thousand dollars. An expanded version of the 2018 property tax relief petition will likely

be on the November 2020 ballot if property taxes are not addressed by then.

Below are estimates of how the "property tax refund" would have been calculated for representative residential and agricultural taxpayers if the 2018 property tax relief petition had been approved by voters. The basic formula is taxable property value times property tax rate times 30 percent (half of the 60 percent of property taxes that went for schools). Rural property tax rates are lower because they do not include city property taxes.

- \$150,000 house x 1.6% x .3 = \$720 refund
- \$2.5 million farm x 1.2% x .3 = \$9000 refund

If the 2018 property tax petition had been on the November 2018 ballot and enacted by voters, the Governor and state legislators would now be debating how to pay for the \$1.1 billion of property tax relief. Likely sharp state spending cuts and steep sales and income tax increases would have been needed to deal with the \$1.1 billion state budget gap. To help bring this into focus, Governor Ricketts correctly observed that in order to close the \$1.1 billion budget gap, state spending could be reduced the needed 25 percent by shutting down all state agencies and also by cutting the University of Nebraska state budget in half. If the budget gap were closed by increased taxes alone (no state spending cuts), sales and income taxes both would have increased about 24 percent. There is no magic way to accomplish property tax relief of this magnitude without either increasing other taxes substantially, substantially reducing state and local spending or both.

State spending overview. State aid to K-12 education is \$1.3 billion, 29 percent of Nebraska's General Fund annual spending; the largest single state expenditure category. Even though Nebraska is low relative to most other states regarding the state's share of total public school costs, state school aid is nonetheless the single largest element in the state budget. The remaining state budget categories and amounts are:

- Medicaid-CHIP \$856 million, 19%
- State aid to individuals \$803 million, 18%
- Higher education \$730 million, 16%
- Law enforcement/public safety \$501, million, 11%
- Other state agencies \$160 million, 4%
- State aid to local governments \$98 million, 2%
- Total: \$4.456 billion

State school aid distribution. How state aid is distributed to school districts across the state affects local property taxes. There are two principal components to the Nebraska state school aid distribution formula: equalization aid and foundation aid. *Equalization*

aid refers to state aid to school districts with lower per-pupil property tax valuation. This is also called “need-based” aid. *Foundation aid* is equal to per-pupil state aid across the board, without regard to the amount of per-pupil property tax valuation. Currently, with high ag land values across the state, 85 percent of state aid goes to non-agricultural areas and 15 percent is distributed across the board to all school districts. Two-thirds of Nebraska school districts (largely rural) receive little or no state aid. Some state senators would like to rebalance the state school aid formula so that 50 percent is need based and 50 percent is across the board. This state aid shift would move about a third of the current state school aid away from urban schools to rural schools.

Spending cuts or tax shifts? One reason we have not achieved property tax relief in Nebraska is due partly to different political philosophies on how best to accomplish it: through spending cuts or through a tax shift? The *spending cuts* approach would pay for property tax cuts by cutting state and local spending. The *tax shift* approach would pay for property tax cuts by expanding the Nebraska sales tax base to include services and using that new revenue for property tax relief. This philosophical stalemate has resulted in property tax policy gridlock. One reason Nebraska sales taxes are relatively low compared to other states is that we don’t tax services and many other states do. This type of tax shift may be the only realistic way to pay for the level of property tax relief that could head off a 2020 property tax relief ballot petition. But increasing sales taxes has historically been opposed by business and consumer interests, who are likely to continue their opposition. So there is no easy answer here.

Political economics. Pretend you are a political consultant to a group seeking reduced property taxes. How would you advise your clients? If the objective is to find--say--\$600 million dollars in property tax relief, your strategy would likely include a state school aid shift and a tax shift. The *state school aid shift* would change state aid distribution from 85 percent equalization-15 percent across the board to something like 50 percent equalization-50 percent across the board. This would move \$300-350 million in state aid away from urban schools to rural schools. The *tax shift* would expand sales taxes to untaxed goods and services and use the increased revenue for property tax relief. Current sales tax exemptions, and the amounts of sales tax revenue each exemption would generate, if not exempted, are listed below.

A quick review of these figures suggests that the largest sales tax exemptions are among the most popular (medical expenses, gasoline, groceries), while more of the less popular exemptions (perhaps junk food, haircuts and beauty salons, weight loss clinics, dry cleaning, etc.) would yield much less sales tax revenue. Every sales tax exemption has its defenders who would likely oppose losing their exemption to help fund property tax relief efforts.

Other options. Consider reforming business incentive programs (\$360 million in 2016); increase state income taxes (currently about \$400 million below what roughly equal revenue from property, sales and income taxes would be).

\$198 million: physician services	\$8.6 million: moving and storage services
\$194 million: purchases by non-profits	\$7 million: accounting services
\$183 million: motor fuels	\$7 million: chiropractor services
\$166 million: groceries	\$6 million: investment advice
\$164 million: Rx, home health care Rx	\$4.5 million: mental health services
\$63 million: legal services	\$4.4 million: optometrist services
\$41 million: dentist services	\$4 million: other personal services (weight loss, tattoos, funeral and cremation, etc.)
\$33 million: real estate agent services	\$2.6 million: dry cleaning & clothing repair
\$20 million: other outpatient services	\$2 million: travel agencies
\$19 million: motor vehicle cleaning, repairs	\$1 million: transportation services (taxis, limo rentals, etc.)
\$16 million: pet services	About \$1.2 billion in total
\$13 million: home repair etc services	
\$11 million: personal grooming services	

Major 2019 Bills

Property tax relief will be a high profile issue in the 2019-2020 legislative sessions. Some tax shift opponents have been term-limited out of the Unicameral, although Governor Ricketts is a tax shift opponent. We will take a quick look at some of the major property tax/school funding proposals before commenting on the obstacles to property tax relief in the 2019-2020 sessions, as well as the potential impact of enacting the 2020 property tax relief ballot initiative.

LR3CA, introduced by Sen. Steven Erdman (Bayard), would amend the Nebraska Constitution to establish refundable state income tax credits of 35 percent of the taxpayers' total property taxes paid. LR3 would likely cost around \$1.4 billion, 31 percent of the state General Fund budget. LR3 would create a major state budget crisis to fund through state spending cuts and tax increases. -LR3 is what the Governor and state senators have two years to try to avoid by adopting significant property tax relief before the November 2020 general election.

If LR3 were enacted, this is how taxpayers' "property tax refunds" would be calculated:

$\$150,000 \text{ house} \times 1.6\% \times .35 = \840 refund

$\$2.5 \text{ million farm} \times 1.2\% \times .35 = \$10,500 \text{ refund}$

The Governor's plan includes (1) increasing state property tax credits \$51 million annually; (2) adopting a proposed constitutional amendment to limit property tax increases to 3 percent per year; (3) adopting an income capitalization rate for agricultural land to lower property tax valuations, and (4) increasing state school aid around \$52 million per year.

LB314, introduced by Sen. Tom Briese (Albion) was developed by Nebraskans United, which includes agricultural, education and public health representatives. LB314 would impose sales taxes on candy, pop, bottled water, home remodeling, haircuts, and auto repairs. The bill would also increase the state sales tax rate one half cent, increase cigarette taxes \$1.50/pack, triple beer and alcohol taxes, and remove most state income tax itemized deductions (but not for medical expenses). LB314 would provide \$510 million in property tax relief, and would increase state school aid by \$236 million. LB314 is the only major proposal with an urban senator co-sponsor, indicating at least some urban support for the bill.

LB695, introduced by Sen. Mike Groene (North Platte), would change the state school aid distribution formula to guarantee \$3500 of state aid per pupil to every school district.

LB497, introduced by Sen. Curt Friesen (Henderson), would give every school district 50 percent state aid. The bill would lower ag land valuation for school taxation from 75 percent to 40 percent over time and would limit school

spending increases. LB497 would provide \$523 million in new revenue, including sales taxes on groceries, house cleaning and vehicle repairs, as well as increased taxes on tobacco and alcohol.

Other tax and school funding bills have been proposed. The bills will be heard in committee in February and March. The bills making it out of committee should reach the floor sometime in late March or early April. The floor debates will be robust, contentious, and headline news for as long as they continue.

Discussion. Senators Briese and Friesen have both proposed controversial bills that would provide substantial property tax relief at a level that would have a fighting chance to head off a 2020 property tax relief ballot initiative. Their bills also provide funding for the property tax relief through (1) a state school aid shift and (2) a tax shift onto sales taxes. One or both bills are likely to be advanced out of committee to floor debate in March or April. So there should be enough time to give these important property tax relief proposals a meaningful legislative debate.

It will take several urban votes to enact any property tax relief proposal: 33 votes are needed to overcome a legislative filibuster, and 30 votes are needed to override a gubernatorial veto. To obtain this urban support, some of the state aid lost by urban districts in any state aid shift will need to be made up at least in part.

The LR3 property tax relief initiative petition basically gives the Unicameral and Governor this year and next year to adopt a property tax relief program. If they don't, they will leave the door open for voters to give themselves a 35 percent property tax cut, something many voters would be eager to do. And Governor Ricketts and the 2021 Unicameral would have a historic state budget crisis to solve.

Property tax reform will not be easy or straightforward. A major issue is whether consumers are willing to pay higher sales taxes in order to receive property tax relief. Some will and some won't. It would be best to have school funding issues resolved in the Unicameral instead of at the ballot box. But if the Unicameral remains deadlocked on this issue, voters may choose to have the final word.

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